



Date: January 13, 2003

To: Hon. Edward Chavez, Chair
Assembly Committee on Revenue and Taxation
Attention: Ms. Kimberly Bott, Chief Consultant

From: Mark A. Ibele *Mi*
Principal Fiscal and Policy Analyst

Subject: Tax Expenditure Programs

You have requested that our office provide to you an update of the fiscal estimates for the tax expenditure programs (TEPs) that were identified in our February 1999 report entitled *California's Tax Expenditure Programs*.

In Figure 1 (attached), we have provided a list of all current TEPs for the personal income tax, and bank and corporation tax, and their estimated revenue effects for 2002-03. The Franchise Tax Board, which administers these taxes, prepares fiscal estimates for all major TEPs associated with these taxes on an annual basis. For the sales and use tax, other state taxes, and the property tax, which are administered in whole or in part by the Board of Equalization, estimates of TEPs are not prepared on a regular basis. For these TEPs, the most recent estimates are for 1998-99, which were presented in our report and are restated in Figure 2 (attached) for your convenience.

In addition to the above fiscal estimates, we have provided information regarding: (1) any additional TEPs enacted and (2) changes in existing TEPs, that occurred since the publication of the report.

Other than the changes noted in the figures, the basic nature of the various TEPs remain unchanged from our report. If you would like further explanation of the various programs or require additional information please contact me at 319-8308.

Attachments

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ATTACHMENT 1

Figure 1

California's Tax Expenditure Programs

Taxes Administered by the California Franchise Tax Board

(Dollars in Millions)

	Estimated Revenue Loss 2002-03	Comments
A. Personal Income Tax		
Exclusions		
Capital Gains at Death	\$1,480	Assumes that appreciated property is sold upon death of owner.
Capital Gains on Sales of Principal Residences	700	
Employer Contributions to Health Plans	2,830	
Pension Contributions and Earnings	3,240	
Unemployment Insurance Benefits	52	
Social Security Benefits	1,000	
Employer Contributions to Life Insurance	89	
Investment Income on Life Insurance and Annuity Contracts	900	
Meals and Lodging Furnished by Employer	33	
Benefits Provided Under Cafeteria Plans	470	
Miscellaneous Fringe Benefits	220	
Scholarships, Fellowships, and Grants	52	
Income for Investment in Economically-Depressed Areas	N/A	
Foster Care Payments	19	
Employer-Provided Child Care	30	
Payments for Recycled or Redeemed Beverage Containers	N/A	
State Lottery Winnings	52	
Scholarshare Trust Income	2	
Small Business Stock	30	1999 legislation removed sunset date.
Employer-Provided Educational Assistance	7	
AMT Elimination for Exemption Credits	2	
Graduate Student Expenses	10	2000 legislation for employer-paid expenses.
Exemptions		
Interest on California and Local Debt Obligations	\$345	
Compensation for Injuries and Sickness	265	
Employee Stock Ownership Plans (ESOPs)	1	
Limited Partnerships Investment Source Rule	10	

Continued

Figure 1

California's Tax Expenditure Programs

Taxes Administered by the California Franchise Tax Board

(Dollars in Millions)

	Estimated Revenue Loss 2002-03	Comments
Adjustments		
Contributions to Individual Retirement Account (IRA)	\$59	
Education IRA	— ^a	
Contributions to Self-Employed Retirement Plans	300	
Health Insurance Paid by Self-Employed Taxpayers	100	1999 legislation increased the deduction percentage.
Moving Expenses	9	
Deductions		
Standard Deduction	\$850	
Medical and Dental Expenses	125	
Real Property Taxes	830	
Other Taxes	55	
Home Mortgage Interest	3,260	
Charitable Contributions	1,160	
Contributions Through Tax Return Check-offs	— ^a	
Casualty Losses	7	
Employee Business and Miscellaneous Expenses	465	
Accelerated Depreciation of Rental/ Low-Income Housing	100	
Accelerated Depreciation of Other Structures/ Child Care Facilities	19	
Accelerated Depreciation of Equipment/ Pollution Control Equipment	260	
Accelerated Depreciation of Cogeneration and Alternative Energy Equipment	N/A	
Accelerated Depreciation of Reforestation Expenditures	N/A	
Enterprise Zone/Program Area Accelerated Write-off and Interest Exclusion	N/A	
Expensing Agricultural Costs	7	
Expensing Exploration, Development, and Research Costs	7	
Expensing Environmental Remediation Costs	2	
Expensing Magazine Circulation Costs	2	
Carryover of Net Operating Losses (NOLs)	0	2002 legislation suspended NOL carryover claims during 2002 and 2003. Revenue loss would be \$220 million without suspension.
Percentage Depletion of Mineral and Other Natural Resources	8	

Continued

Figure 1

California's Tax Expenditure Programs

Taxes Administered by the California Franchise Tax Board

(Dollars in Millions)

	Estimated Revenue Loss 2002-03	Comments
Subchapter S Corporations	-540	Revenue gain due to taxation at the individual level.
Medical Savings Accounts	1	
Student Interest	8	
Credits		
Personal Exemption	\$950	
Dependent Exemption	1,250	
Senior Exemption	98	
Blind Exemption	1	
Qualified Senior Head of Household	— ^a	
Renters' Credit	95	
Enterprise Zone Hiring, Sales and Use Tax	49	
Research and Development	33	
Residential Rental and Farm Sales Carryover	1	
Low-Income Housing	5	
Employer Child Care Expenses	3	
Recycling Equipment and Carryover	— ^a	
Ridesharing Expenses and Carryover	1	
Prison Inmate Labor	— ^a	
Tax Incentive Zones ^b	1	
Los Angeles Revitalization Zone (LARZ)	8	
Manufacturers' Investment Credit (MIC)	50	
Trout Habitat	— ^a	
Enhanced Oil Recovery	— ^a	
Farmworker Housing	— ^a	
Rice Straw	— ^a	
Transport of Agri-Products Donation	— ^a	
Child Adoption	26	
Credentialed Teachers	5	2000 legislation granted credit of up to 50 percent of teacher-related income. 2002 legislation suspended credit for 2002. Revenue loss would be \$180 million without suspension.
Long-Term Care of Elderly or Disabled	2	2000 legislation granted \$500 credit for home care of elderly and disabled.
Child Care Expenses	195	2000 legislation granted refundable, income-limited credit.

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Figure 1

California's Tax Expenditure Programs Taxes Administered by the California Franchise Tax Board

(Dollars in Millions)

	Estimated Revenue Loss 2002-03	Comments
National Heritage Preservation	1	2000 legislation granted credit for conservation of certain lands.
Solar Energy Systems	10	2001 legislation granted credit for the purchase of approved solar energy systems.
Community Development Investment Credit	N/A	
B. Corporation Tax		
Exclusions		
Investment Income on Life Insurance and Annuity Contracts	\$42	
Income for Investment in Economically-Depressed Areas	N/A	
Payments for Recycled or Redeemed Beverage Containers	N/A	
Minimum Tax for New Corporations	62	1999 legislation eliminated minimum tax for first two years.
Exemptions		
Exempt Status for Qualified Corporations	\$125	
Water's-Edge Election	340	
ESOPs	3	
Deductions		
Charitable Contributions	\$115	
Casualty Losses	— ^a	
Reserve Method for Bad Debts	N/A	2002 legislation levied tax on 50 percent of loan loss reserves and exempted 50 percent from tax.
Enterprise Zone/Program Area Accelerated Write-off and Interest Exclusion	N/A	
Accelerated Depreciation of Rental/Low-Income Housing	N/A	
Accelerated Depreciation of Other Structures/Child Care Facilities	N/A	
Accelerated Depreciation of Equipment/Pollution Control Equipment	N/A	
Accelerated Depreciation of Cogeneration and Alternative Energy Equipment	N/A	
Accelerated Depreciation of Reforestation Expenditures	N/A	

Continued

Figure 1

California's Tax Expenditure Programs
Taxes Administered by the California Franchise Tax Board

	Estimated Revenue Loss 2002-03	Comments
Enterprise Zone/Program Area Accelerated Write-off and Interest Exclusion	N/A	
Expensing Agricultural Costs	5	
Expensing Exploration, Development, and Research Costs	150	
Expensing Environmental Remediation Costs	2	
Expensing Magazine Circulation Costs	2	
Carryover of NOLs	95	2000 legislation increased the percentage of NOL carryover on a phased-in basis. 2002 legislation suspended carryover claims for 2002 and 2003. Revenue loss would be \$840 million without suspension.
Percentage Depletion of Mineral and Other Natural Resources	15	
Expensing Employer Ridesharing Program Costs	N/A	
Subchapter S Corporations	2,445	
Credit Union Treatment	10	
Credits		
Enterprise Zone Hiring, Sales and Use Tax	\$100	
Research and Development	625	1999 legislation increased credit rate to 12 percent; 2000 legislation increased credit rate to 15 percent and increased alternative credit.
Low-Income Housing	33	
Employer Child Care Expenses	2	
Recycling Equipment and Carryover	— ^a	
Ridesharing Expenses and Carryover	— ^a	
Prison Inmate Labor	— ^a	
Tax Incentive Zones ^b	3	
Los Angeles Revitalization Zone (LARZ)	25	
Manufacturers' Investment Credit (MIC)	410	
Trout Habitat	— ^a	
Enhanced Oil Recovery	— ^a	
Farmworker Housing	— ^a	
Rice Straw	— ^a	
Transport of Agri-Products Donation	— ^a	
Joint Strike Fighter	11	
National Heritage Preservation	9	2000 legislation granted credit for conservation of certain lands.
Solar Energy Systems	23	2001 legislation granted credit for the purchase of approved solar energy systems.
Community Development Investment	N/A	

^a Estimated revenue loss of less than \$500,000.

^b Includes Local Area Military Base Recovery Area, Targeted Tax Area, and Manufacturing Enhancement Area.

ATTACHMENT 2

Figure 2

California's Tax Expenditure Programs Taxes Administered by the State Board of Equalization

(Dollars in Millions)

	Estimated Revenue Loss 1998-99	Comments
A. Sales and Use Tax		
Gas, Electricity, Water, Steam, and Heat	\$3,264	
Organic Products Grown Expressly for Fuel Purposes	— ^a	
Agricultural, Timber, Municipal, and Industrial Waste By-Products	N/A	
Use of Refiners' Gas	N/A	
Animal Life	47	
Animal Feed	207	
Seeds and Plants	30	
Qualified Fertilizer	52	
Poultry Litter	1	
Food Products	2,698	
Candy, Gum, and Confectionery Products	217	
Bottled Water	93	
Packing Ice and Dry Ice	N/A	
Carbon Dioxide Used in Packaging	— ^a	
Prescription Medicines	709	
Specified Medical-Related Products	N/A	
Medical Identification Tags	— ^a	
Specified Medical Health Information	N/A	
Health and Safety Insignia and Educational Materials	N/A	
Food Animal Medicines	4	
Medicated Feed and Drinking Water	— ^a	
Printers' Aids	N/A	
Partnership Property Used to Produce Motion Pictures	N/A	
Newspapers and Periodicals, Distributed Free of Charge or by Subscription	74	
Leases of Motion Pictures	32	
Master Tapes and Master Records	N/A	
Printed Advertising Materials	N/A	
Motion Pictures and Production Services	N/A	
Mobile Transportation Equipment Leases	N/A	
Vessels That Transport Over 1,000 Tons	N/A	
Vehicles Modified for Physically Handicapped Persons	N/A	
New or Remanufactured Trucks and Trailers For Out-of-State Use	N/A	
Property Used in Space Flights	12	
Aircraft Repair and Related Equipment	\$16	
Railroad and Related Equipment	— ^a	
Leases of Specified Linens	44	
Leases of Household Furnishings	— ^a	

Continued

Figure 2

**California's Tax Expenditure Programs
Taxes Administered by the State Board of Equalization**

(Dollars in Millions)

	Estimated Revenue Loss 1998-99	Comments
Factory-Built Housing	— ^a	
New Mobilehomes	N/A	
Used Mobilehomes	24	
Custom Computer Programs	276	
California Gold Medallions	— ^a	
Monetized Bullion, Gold and Silver Bullion, and Numismatic Coins	N/A	
Returnable Containers	N/A	
Containers Whose Contents are Tax-Exempt	N/A	
Original Artworks and Displays For Specified Museums	N/A	
Single-Use Mailing Lists	N/A	
Sale-Leasebacks Involving Certain Governmental Entities	N/A	
Motor Vehicle Fuel Used in Airplanes	N/A	
Fuel Sold to Air Common Carriers For International Flights	20	
Fuel Used in Water Common Carriers	18	
Meals and Food Products Served in Schools	N/A	
Hot Food Products Served To Airplane Passengers	N/A	
Meals Served to Patients and Residents of Health Care Facilities	N/A	
Meals Provided to Qualified Low-Income Senior Citizens	N/A	
Meals Delivered to Elderly and Disabled Individuals	— ^a	
Meals Prepared in Common Kitchen Facilities For Qualified Senior Citizens	N/A	
Meals and Food Products Served by Religious Organizations	N/A	
Food Stamp Purchases	N/A	
Health Care Professionals Treated as Consumers	N/A	
Veterinarians Treated as Consumers	N/A	
Aircraft for Common Carriers or for Use by Foreign Governments or Nonresidents	N/A	
Trailers And Semitrailers Moved to Place of Sale	N/A	
Qualified Watercraft and Their Component Parts	N/A	
Vehicles, Vessels, and Aircraft Transferred Within a Family	N/A	
New Vehicles Sold to Foreign Residents For Foreign Shipment	N/A	
Occasional Sales	— ^b	
Occasional Sales of Vehicles, Vessels, or Aircraft	N/A	
Occasional Sales of Other Products by Hay Producers	N/A	
Membership Fees Charged by Consumer Cooperatives	N/A	
Clothing Alterations by Clothes Cleaning and Dyeing Businesses	N/A	

Continued

Figure 2

California's Tax Expenditure Programs Taxes Administered by the State Board of Equalization

(Dollars in Millions)

	Estimated Revenue Loss 1998-99	Comments
Flags Sold By Veterans' Groups	— ^a	
Vending Machine Sales of Nonprofit Operators	— ^a	
Photocopy Sales By Libraries	N/A	
Prisoner-of-War Bracelet Sellers	— ^a	
Veterans Memorial Lapel Pins	— ^a	
Qualified Sales of Youth Groups	N/A	
Yearbook and Catalog Sales by Student Organizations	N/A	
Replacements for Destroyed Museum Exhibits	N/A	
Sales By PTAs, Co-Op Nursery Schools, and Friends of the Library	N/A	
Rummage Sales by Qualified Nonprofit Organizations	— ^a	
Handcrafted Items Sold by Qualified Organizations	— ^a	
Charitable Organization Sales and Donations	N/A	
Property Loaned to Educational Programs	N/A	
New Clothing Donated to Elementary School Children	N/A	
First \$400 of Foreign Purchases Hand-Carried Into California	— ^a	
Charitable Donations Made by Sellers	N/A	
Auctions Involving Nonprofit Organizations	— ^a	
Sales by Thrift Stores Operated By Nonprofit Organizations	— ^a	
Option to Pay Tax on Cost Rather Than Lease Receipts	N/A	
Tax Liability on "Bad Debts"	N/A	
Acquisition Sale-Leaseback Arrangements	N/A	
Factory-Built School Buildings	— ^a	
Endangered Animal and Plant Species	— ^a	
Investments by Manufacturers	\$6	
Rural Investment Exception	5 ^c	2000 legislation exempted certain purchases.
Farm and Forestry Equipment	20 ^d	2001 agriculture assistance package.
Liquified Petroleum Gas in Rural Areas	7 ^d	2001 agriculture assistance package.
Thoroughbred Breeding Stock	1 ^d	2001 agriculture assistance package.
Diesel Fuel for Agriculture	19 ^d	2001 agriculture assistance package.
B. Other State Taxes		
Alcohol Used in Trades, Professions, and Industries	N/A	
Beer Consumed by Brewers' Employees	— ^a	
Distilled Spirits Used in the Manufacture of Food Products	N/A	
Distilled Spirits Used for Research And Medical-Related Purposes	N/A	
Distributions of Tobacco Products to U.S. Armed Forces And the U.S. Department of Veterans' Affairs	\$21	

Continued

Figure 2

**California's Tax Expenditure Programs
Taxes Administered by the State Board of Equalization**

(Dollars in Millions)

	Estimated Revenue Loss 1998-99	Comments
Distributions of Tobacco Products To Veterans' Institutions	— ^e	
Small Shipments of Cigarettes Transported Into California	— ^e	
Natural Gasoline	N/A	
Ship or Aircraft Fuel Ultimately Distributed to the U.S. Armed Forces	N/A	
Fuel for Off-Highway Vehicle Operations	N/A	
Fuel Sales to Consulate Officers And Employees	N/A	
Fuel for Race Cars	N/A	
Fuel for Common Carriers and the Military	80	
Fuel for Construction and Agricultural Machinery	N/A	
Fuel for Nontransportation Purposes	N/A	
Fuel for Off-Highway Vehicle Operations	N/A	
Fuel for Local Transit and School Bus Operators	22	
Fuel for Out-of-State Tour Buses	N/A	
Fuel for Public Agency Vehicles Operated on Military Installations	N/A	
Fuel for Operation of Vehicles on U.S. Department of Agriculture Roads	N/A	
Fuel for the U.S. Government And Its Instrumentalities	N/A	
Fuel Used in Public Transit Vehicles	N/A	
Liquified Petroleum Gas	2	
Ethanol and Methanol	— ^a	
Natural Gas	— ^a	
Flat Tax Rate for Liquified Petroleum Gas and Natural Gas Fuels	N/A	
Employee Pension and Profit Sharing Plans	N/A	
Fraternal Benefit Societies	N/A	
C. Property Taxes		
Homeowners' Exemption	\$362	
Household Furnishings	500	
Transfers Between Spouses	N/A	
Transfers Between Family Members	1	
Replacement Housing Purchased by Senior Citizens	N/A	
Transfers Within a Joint-Tenancy Agreement	N/A	
Mobilehome Park Property Transfers to Tenant Cooperatives	N/A	
Business Inventories	1,940	
Financial Assets	N/A	
Business Records	N/A	
Transfers of Interests in Corporate or Partnership Property	N/A	
Transfers to Employee Benefit Plans	N/A	

Continued

Figure 2

California's Tax Expenditure Programs
Taxes Administered by the State Board of Equalization

(Dollars in Millions)

	Estimated Revenue Loss 1998-99	Comments
Computer Programs	100	
Motion Pictures	N/A	
Hand Tools	1	
Returnable Containers for Soft Drink Beverages	N/A	
State and Local Governments	N/A	
Leases by a Nonprofit Corporation To a Government	N/A	
Volunteer Fire Departments	N/A	
Restricted Historical Property	N/A	
Aircraft Owned by a Government Agency	N/A	
Federal Property Used for Migratory Fowl	— ^a	
Hospital, Educational, Museum, Scientific, or Charitable Purposes ("Welfare Exemption")	415	
Religious Worship or Religious Purposes ("Church Exemption")	89	
Transfers Within The Same Religious Denomination	1	
Leases by a Charitable Organization To a Government for Charitable Purposes	N/A	
Private Property Used by a Public Library or Free Museum	1	
Public Schools, Colleges, and Universities	1	
Private Colleges and Seminaries	72	
State College Management	N/A	
Student Bookstores	1	
Student Body Organizations	N/A	
Nonprofit Entities Using Property for Selected Public Purposes	N/A	
Designated Institutions	N/A	
Cemetery Property	5	
San Diego Supercomputer Center	N/A	
Disaster-Damaged Property	N/A	
Property Damaged by Misfortune or Calamity	\$1	
Environmental Contamination	1	
Property Condemned Pursuant to Eminent Domain Proceedings	N/A	
Earthquake Safety Improvements	N/A	
Fire-Safety Improvements	N/A	
Improvements for Disabled Accessibility	10	
Homes and Improvements for Disabled Persons	N/A	
Active Solar Energy Systems	N/A	
Veterans' Exemption	— ^a	
Disabled Veterans' Principal Residence	12	
Real Property of Specified Veterans' Organizations	— ^a	
Personal Property of Specified Veterans' Organizations	— ^a	

Continued

Figure 2

**California's Tax Expenditure Programs
Taxes Administered by the State Board of Equalization**

(Dollars in Millions)

	Estimated Revenue Loss 1998-99	Comments
Open-Space Contracts (The "Williamson Act")	97	
Growing Crops	1	
Fruit Trees, Nut Trees, and Grapevines	1	
Diseased Grapevines	N/A	
Restricted Timberlands	N/A	
Low Harvest-Value Timber	N/A	
Seed Potatoes	1	
Vessels	N/A	
Documented Vessels	3	
Vessels Under Construction	N/A	
Vessels With a Market Value of \$400 or Less	N/A	
Air Carrier Ground Time	N/A	
Aircraft Being Repaired	N/A	
Private Railroad Car Repair Days	— ^a	
Cargo Containers Used in Ocean Commerce	N/A	
Exhibition Exemption	N/A	
Works of Art Available for Display	N/A	
Works of Art Owned by the Artist	N/A	
Aerospace Museum Displays	N/A	
Aircraft of Historical Significance	1	
Assessments of \$5,000 or Less	N/A	
Supplemental Roll Tax Assessments Of \$20 or Less	N/A	
Fixtures Excluded From the Supplemental Roll	49	
Interests That Represent Less Than Five Percent of the Property's Total Value	N/A	
Senior Citizens' Relief	\$214 ^c	2000 legislation granted one-time property tax relief.

^a Estimated revenue loss of less than \$500,000.
^b Revenue loss unknown, but likely in excess of \$10 million.
^c Estimated revenue loss for 2000-01.
^d Estimated revenue loss for 2001-02.